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No. 88-1951

In The

Supreme Court of the United States

October Term, 1988

UNITED STATES OF AMERICA,

Petitioner,

v.

FRANCES L. DALM,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

ROBERT B. PIERCE
PAUL T. MENGEL
PIERCE & PIERCE, P.C.
7125 Orchard Lake
Suite 303
West Bloomfield, MI 48322
(313) 626-9895

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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QUESTION PRESENTED

Where the Government has asserted a timely deficiency against Taxpayer and, as a result thereof two taxes have been collected on the same taxable event on mutually exclusive theories, does equitable recoupment permit the Taxpayer to maintain a refund suit against the Government to reduce the amount received by the Government?

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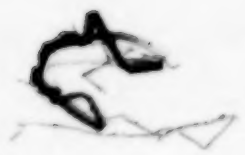
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STATEMENT

Respondent's Statement must be corrected and amplified in the following particulars:

1. The Tax Court trial took place the week of October 15, 1984. The stipulation to the decision was dated October 22, 1984. The Claim for Refund was executed by Frances Dalm on October 29, 1984 and filed November 1, 1984. The dates set forth in the Petition for these events (trial in September, no specific date and claim in November, no specific date) fail to capture the almost immediate nature of the filing of the Claim for Refund, which was pursuant to the specific understanding of the parties that a claim would be filed.

2. The question of the gift tax was specifically left open by the parties. There is no claim in the record by the Government that there was any agreement settling the matter of the gift tax or specifically crediting the amount of the gift tax against the amount paid.

REASONS FOR DENYING THE PETITION

The Petition for a Writ of Certiorari should be denied for the reasons that:

I. The instant case is consistent with this Court's prior decisions.

II. There is no conflict between the Circuits that needs to be resolved.

III. There is no danger of widespread exceptions to the statute of limitations.

IV. Application of the doctrine of equitable recoupment in this case is not contrary to the mitigation provisions of the Internal Revenue Code or the purposes served by statutes of limitation.

I. THE INSTANT CASE IS CONSISTENT WITH THIS COURT'S PRIOR DECISIONS.

The parties agree that the controlling authorities are three Supreme Court cases; namely, *Bull* v *United States*, 295 U.S. 247 (1935), *Stone* v *White*, 301 U.S. 532 (1937) and *Rothensies* v *Electric Storage Battery Co.*, 329 U.S. 296 (1946).

In *Bull*, the business of a Partnership was continued for the balance of the year (1920) in which Mr. Bull died. The post-death profits were included as an asset of the Estate and an Estate tax was paid on that amount in 1921. Subsequently the Commissioner determined that the same post-death profits were income to the Estate and an additional income tax should be paid. The Estate appealed the case to the Board of Tax Appeals which sustained the Commissioner's determination of additional income tax. Thereafter, the Estate paid the tax and instituted a suit for refund in the Court of Claims for the amount ($62,677.44) paid as additional income tax or, in the alternative, for the amount ($47,643.44) paid as estate tax. The suit for refund of income tax paid was not barred by the statute of limitations; however, any suit for refund or credit of Estate tax was untimely and barred by the statute of limitations. The Court of Claims held that the post-death profits were correctly taxed as income but would not offset or credit the erroneous payment of

Estate tax against the correctly paid income tax for the reason that a suit for refund of the Estate tax was barred by the statute of limitations. It was undisputed that the statute of limitations had expired *barring any suit for refund or credit of the overpayment of Estate tax*. (Emphasis added)

This Court, on such facts, held that the Estate was equitably entitled to have credited against the correctly paid income tax, the overpayment of the erroneous Estate tax resulting in a refund to the Estate. In the instant *Dalm* case, as in *Bull*, there was double taxation resulting from inconsistent treatment of the same money and it was too late to file a claim for refund. As observed by this Court in *Bull*, the double taxation involved in such inconsistent treatment resulted in the Government taking more than that to which it was entitled. Retention of the money paid as a gift tax in *Dalm* is against morality and conscience just as retaining the Estate tax in *Bull*, yet, the Government has the temerity to claim that the decision, if permitted to stand would have deleterious consequences for the administration of the tax laws.

In *Stone*, equitable recoupment was applied in favor of the Government to prevent a refund of tax erroneously paid by a Testamentary Trustee, which should have been paid by the Beneficiary where collection from the Beneficiary was barred by the statute of limitations. The principal difference from *Bull* was that the equities favored the Government rather than the Trustee Taxpayer; however, no unjust enrichment resulted to the Government and no injury to the Trustee Taxpayer or the Beneficiary. In *Stone*, application of the doctrine merely resulted in a diminution of the Taxpayer's right to recover, whereas in

Bull, application of the doctrine resulted in a diminution of the Government's recovery. In the instant case there is a diminution in the amount received by the Government which results in no unjust enrichment to the Dalms and no injury to the Government.

The Sixth Circuit in *Dalm* was absolutely correct in stating (page 8a of Appendix to the Petition for a Writ of Certiorari) that: "The facts in *Rothensies* were quite different from those in *Bull* and the present case." Indeed, Special Assistant to the Attorney General, Arnold Raum, who argued the *Rothensies* case, pointedly observed that recovery in that case would not be supported upon equitable principles of recoupment and more importantly that *Bull* was inapplicable because the barred excise taxes did not arise out of the same transaction as the income taxes. While the Taxpayer's suit for refund in *Rothensies* was timely, the claim pleaded as a recoupment was for taxes collected over twenty (20) years before. The basic problem was that there was no single taxable event that had been subjected to two taxes on inconsistent legal theories. *Bull*, *Stone*, the instant *Dalm* case, and *Rothensies* are consistent. All stand for the proposition that the doctrine of equitable recoupment is applicable only where a single taxable event and single transaction has been subjected to two taxes on inconsistent legal theories. Likewise, the doctrine was correctly applied in *Kolom* v *United States* 791 F.2d 769 (9th Cir. 1986); however, in *O'Brien* v *United States*, 766 F.2d 1038 (7th Cir. 1985), *Rothensies* and the other cases cited by the Government, the doctrine correctly should not have been and was not applied.

The Government complains that the decision below if permitted to stand will disrupt the sound administration

of the tax laws. We disagree. It is the government's failure to follow the admonition of this Court in *Bull* that results in deleterious consequences for the administration of the tax laws. The Government's outrageous action in proceeding against a Taxpayer for an income tax deficiency yet at the same time retaining the windfall from taxing the same transaction as a gift causes disruption to the sound administration of the tax laws. The Government has collected two taxes on the same transaction on mutually exclusive theories. In so double dipping it is maximizing dollars rather than following the sound administrative principle of collecting the correct tax, no more and no less. The Government should have allowed a credit for the gift tax paid at the time it proceeded against Frances Dalm for additional income tax.

We do not suggest that the Government should be denied the right to disagree with a Taxpayer by proceeding on an inconsistent theory; however, sound administration as well as fairness would dictate that once it took its position to obtain more money by treating the funds as income then it should give credit for the gift tax paid. No action by a Court was necessary; however, here the Government studiously seeks to perpetuate its unfairness through arbitrary use of power, thus, creating disrespect for and disruption of the sound administration of the tax laws. In short, there is no need for equitable recoupment if the Government plays the game fairly. It follows therefore, that any disruption of the sound administration of the tax laws has been caused by the government's own action in using its power to unfairly maximize dollars and not by the lower Court that remedied the situation.

The Circuit Court quite properly applied the doctrine of equitable recoupment first set forth by this Court with respect to tax laws in *Bull*, thus putting the sound administration of the tax laws back on course.

II. THERE IS NO CONFLICT BETWEEN THE CIRCUITS THAT NEEDS TO BE RESOLVED

The Government's reliance on the decisions in *O'Brien* and *Kolom* for its position that there is a clear conflict between the Circuits is misplaced. In *O'Brien*, two separate taxable events occurred. As stated in *Kolom*, 768 fn 12:

> "Property for estate tax purposes was undervalued and the IRS asserted a deficiency for the undervaluation. Had the correct value been used to report the gain, the taxpayer would have paid less tax. After the IRS changed the value of the property in the estate, the first transaction, taxpayers tried to claim refund of the tax paid as gain on the sale of the property, the second transaction."

The Government wrongly implies that the "main action" which must be timely is the Taxpayer's action. In *O'Brien*, it is clear that the "main action" that had to be timely was the government's assertion of a deficiency and not the Taxpayer's claim for refund. The *O'Brien* Court recognized the distinction in stating at page 1049 that the doctrine will "permit a taxpayer to recoup an erroneously paid tax, the refund of which is time barred, against a timely and correctly asserted deficiency by the government." In fact, later on in its opinion, the Court set forth an instance in which equitable recoupment *perhaps could* have applied as follows:

> "The estate potentially could have recouped Michael O'Brien's income tax overpayment against the excess estate tax owed by the estate *resulting from the Tax Court's stipulated order.* Assertion of the doctrine would be proper because the 'main action,' the government's deficiency suit, would be timely." (emphasis added)

In *O'Brien* the payor was a shareholder of a corporation who sold its stock using an improper lower basis because an Estate improperly had undervalued the stock. Undervaluation of the stock also would benefit the shareholder. Despite the Government's assertion in its Petition (fn 9 at pg 16) that the *O'Brien* Court did not reach its holding because of the lack of identity of the two taxpayers it should be observed that the Court emphasized the difference in identity of interest between the payor of the erroneous overpayment and the recipient of the recoupment concluding that O'Brien was not in a position to invoke the doctrine of equitable recoupment. Lack of identity seemed extremely material to the *O'Brien* Court. Also such footnote, because of its grammatical imprecision, might be read to suggest the *O'Brien* court did not consider the "single transaction" test. In fact, *Rothensies* is specifically cited on the point.

As expressed by many learned Justices, including Holmes, words are not plain in themselves. *Dalm* is not *an independent suit* as the Seventh Circuit in *O'Brien* defined one because the deficiency for additional income tax asserted by the Government against Frances Dalm was timely. In *O'Brien*, at page 1049, it is stated "O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax ***and does not seek to offset the amount of a properly asserted and***

***timely deficiency.*"** (emphasis added) Contrary to the government's assertion that the lack of a properly asserted deficiency played no role in the *O'Brien* Court's decision, the above sentence emphasized by bold type appears immediately before the Court's conclusion that *"This Court sees no grounds for extending the doctrine and the Plaintiff offers none."* The *Dalm* suit, likewise, because recoupment is sought by the proper person against a properly owed tax paid by the same Taxpayer, pursuant to the stipulated Order of the Tax Court after the government's timely assertion of a deficiency, is not an independent action as the Seventh Circuit uses the term. Accordingly, there is no conflict between the circuits that needs to be resolved. Furthermore, the Government's position that the *Kolom* case conflicts with the 1985 Seventh Circuit decision in *O'Brien* is inconsistent with the Seventh Circuit's favorable citation of *Kolom* in its 1988 decision in *First Chicago Corporation* v *Commissioner of Internal Revenue*, 842 F.2d 180 (7th Cir. 1988). The Government apparently saw no conflict between *Kolom* and *O'Brien* in 1988 when it cited *Kolom* to the same Circuit that decided *O'Brien*. Did the conflict just arise in 1989? Indeed, such inconsistency raises a question of credibility.

III. THERE IS NO DANGER OF WIDESPREAD EXCEPTIONS TO THE STATUTE OF LIMITATIONS

From the inception of this action, the Government has maintained that applying equitable encoupment in this case would subvert the statute of limitations and the mitigation provisions as provided for by Congress. That is not the case, and were it the case, it would be a sorry

commentary on the administration of the tax laws. Far from opening the floodgates, the doctrine would never be applicable at all if the Government did not seek to retain unjust windfalls. Fortunately, the unfair windfall taxation of the identical transaction on two mutually exclusive theories is relatively rare. Section IV C of the Sixth Circuit's opinion, examines all of the cases cited by the Government and is able to find *no other instance* in which two taxes are paid on the identical transaction. In fact, far from providing a gaping loophole in the statute of limitations, the doctrine of equitable recoupment provides a pressure release valve in those rare cases when the statute of limitations is used by one side or the other to have it both ways, the Government to collect two taxes or the Taxpayer to pay none. The deficiency in income tax for 1976 and 1977 was not asserted against the Dalms until 1983, long after the statute of limitations had expired on seeking a refund for the gift tax. The fundamental unfairness of expecting the taxpayer to do so is noted in *Kolom* at 767 (fn 11).

> "Kolom's minimum tax liability for 1972 was not finally determined until 1981. Thus, Kolom was effectively precluded from asserting a timely claim for refund. Although Kolom had until April 15, 1977 to file a timely claim for refund under IRC Section 6511, to require him to do so would have placed him in the difficult position of requesting refund of a tax he asserted was correctly paid."

None of the three cases cited by the Government, *Ellard* v *United States*, 228 Ct. Cl. 815 (1981), *Brigham* v *United States*, 470 F.2d 571, 577 (Ct. Cl. 1972), cert. denied, 414 U.S. 831 (1973) and *Evans Trust* v *United States*, 462

F.2d 521, 525-526 (Ct. Cl. 1972) deal with two taxes being collected on the same transaction.

In *Ellard* a partner sold diesel fuel to a partnership and then the partnership sold the same fuel to customers for highway use. The Partnership attempted to recoup excise taxes erroneously paid on diesel fuel when it was sold to the partnership against the taxes rightly owed by the partnership when it sold the fuel for highway use. As noted by the court, this case involved two separate transactions (and two separate taxable events).

In *Brigham*, the taxpayers sought to recoup tax paid at ordinary income rates on the installment sale payments received in 1958 through 1961 after the Internal Revenue Service had acknowledged the installments received in 1962 were to be taxed as a capital gain. This case also involved different transactions and in fact, different tax years.

Evans Trust is even further afield. As no deficiency was determined to exist in estate tax, only income tax was collected. There may have been only one transaction but, properly, there was only one tax.

The mitigation provisions deal with a number of specified instances, but would not have helped the taxpayer in *Bull*. The mitigation provisions are limited to inconsistent payments of the same kind of tax (See Reg. Section 1311(a) 2(b)). Paying both estate and income or gift and income tax on the same transaction is not covered. There was no need for Congress to add such a provision to the tax law. It already existed in the doctrine of equitable recoupment.

No uncertainty will exist in the law as a result of *Dalm*. Each taxable event is to be taxed once. This is by no means a revolutionary principle. Only double taxation on inconsistent theories of the same taxable event is correctable pursuant to the doctrine of equitable recoupment. Judge Learned Hand cogently stated the principle in *Elbert* v *Johnson*, 164 F.2d 421, 424-425 (2d Cir. 1947) as follows:

> " . . . If the transaction is susceptible of two interpretations, and the Taxpayer has paid a tax which was required by the interpretation he puts upon it, he does not forfeit the right to a refund of that tax because the statute of limitations has run against him before the courts have finally decided that his interpretation was wrong; *the statute is tolled*. (emphasis supplied)"

IV. APPLICATION OF THE DOCTRINE OF EQUITABLE RECOUPMENT IN THIS CASE IS NOT CONTRARY TO THE MITIGATION PROVISIONS OF THE INTERNAL REVENUE CODE OR THE PURPOSES SERVED BY STATUTES OF LIMITATION.

In its Petition for a Writ of Certiorari, the Government has cited Andrews, "Modern-Day Equitable Recoupment and the Two Tax Effect:" Avoidance of the statutes of limitation in Federal Tax Controversies, 28 Ariz. L. Rev. 595 (1986) in opposition to *Kolom*. In fact, the principal thrust of the article is that the doctrine is alive and well, has a valid and legitimate value to both the Government and Taxpayers and indeed should not be restricted. Unfortunately, the article did not analyze *Kolom* in any great detail; however, *Kolom* was cited

favorably on several points (see, for instance fn. 147, page 620).

Further, in the article, two of the Government's arguments are completely refuted. For instance, with regard to the mitigation provisions, it is said:

> "Congress apparently did not envision them as entirely displacing these judicial doctrines, but rather serving as a supplement to them." Andrews, p. 621, citing at fn150. S.Rep. No. 1567, 75th Cong., 3d Sess 49 (1938)

It is further pointed out that the "statutory mitigation provisions deal solely with income taxes." Ibid.

Accordingly, it is clear that the statutory mitigation provisions, IRC Sections 1311-1314, are entirely separate from and unrelated to the case at bar.

In addition, the article closed with a lengthy analysis of the reasons and philosophy behind statutes of limitation. Andrews at 644-647. The rationale of statutes of limitation as they relate to equitable recoupment is set forth at 645-646:

> "Given the foregoing reasons for the existence of tax limitation statutes, particularly that of preventing the litigation of stale claims, their relationship to the single transaction element of equitable recoupment and to the automatic facet of *Bull*, quickly becomes apparent. The Supreme Court seemingly imposed the single transaction element of the doctrine because it helps avoid the very staleness problem against which limitations are principally directed. Where a single item, transaction or taxable event is under scrutiny in connection with the open claims of one party, the facts of such transaction relating to the barred claim of the other party are, almost by definition, the same or related and substantially known. Consequently,

> the single transaction concept helps ensure a minimal staleness problem. Obviously in such a situation the negation of a statute of limitation by the application of equitable recoupment is more palatable.
>
> The same may be said of the automatic facet of *Bull* which is also present in *Herring-Bowcut* and *Wilmington Trust*. In each of these cases the determination of the open claim leaves little or no factual issue with respect to the barred claim, and, hence, no real problem of staleness exists. Unlike the justifiable fear voiced by the Court in *Electric Storage Battery*, here no search with respect to the barred claim is either invited or necessary as it is already automatically known."

The "automatic feature" of *Bull* is described at 644.

> "Another obvious, but unemphasized, feature of *Bull*, however, was the automatic nature of its conclusion with respect to the barred estate tax refund claim of the taxpayer once the Court made its determination as to the open income tax claim of the government (being litigated in the setting of the taxpayer's income tax refund suit). That is, once the Court determined that the post-death partnership profits were property subject to the income tax, it was pretty much automatic, in the circumstances of that case, that such profits had been improperly subjected to the estate tax."

With respect to the Government's claim (pg 16 of its Petition) that the decision below would undermine the goals of finality and repose, the following language at page 646 is particularly appropriate:

> "The concept of final repose also does not seem to be overwhelming importance where the claim of one party may only be inchoate or not even exist until the determination concerning the open claim has occurred, at which time the former may already be barred."

In *Dalm* as in *Bull*, nothing is left to be determined on stale evidence. If it was a gift, it was not income. If it was income, it was not a gift. The Tax Court's decision gave rise to a circumstance (gift tax collected on income) that automatically required a refund.

CONCLUSION

The *Dalm* case has been rightly decided. Therefore, the Petition For Writ of Certiorari should be denied.

Respecfully submitted,

Robert B. Pierce
Paul T. Mengel